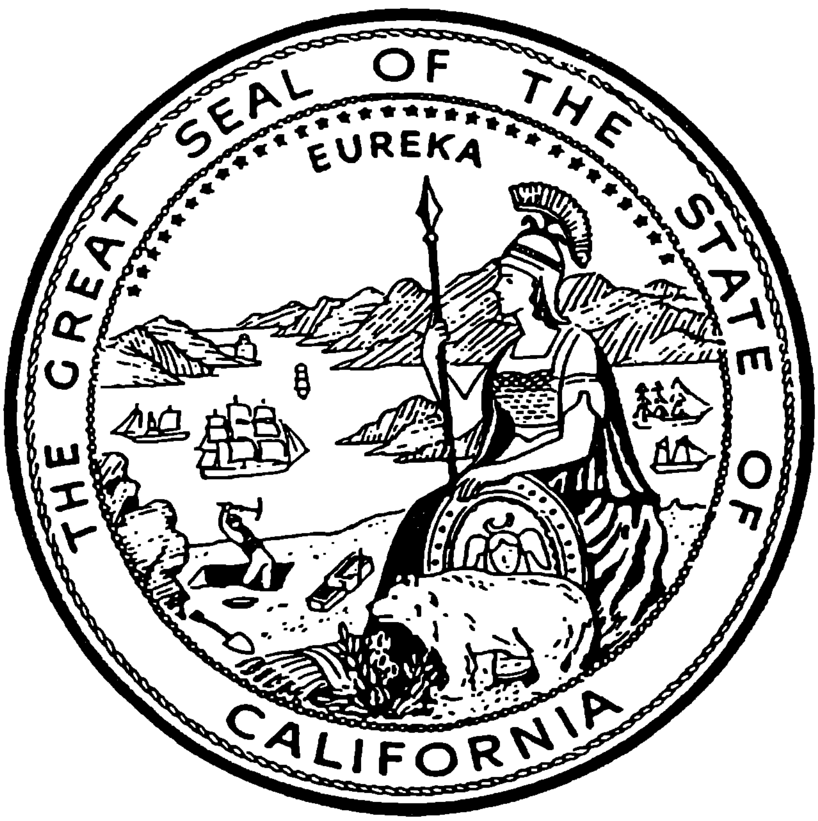
APPENDIX A

THE STATE OF CALIFORNIA



Honorable Matt Fong
Treasurer of the State of California

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OVERVIEW OF STATE ECONOMY AND GOVERNMENT

Introduction

California's economy, the largest among the 50 states and one of the largest in the world, has major components in agriculture, manufacturing, high technology, trade, entertainment, tourism, construction and services. California's economy is approaching a major milestone in 1997 as gross state domestic product is expected to pass the $1 trillion mark. As a stand-alone economy, California's economy would rank seventh in the world, ahead of China's and behind the United Kingdom's.

From 1990-1993, the State suffered through a severe recession, the worst since the 1930's, heavily influenced by large cutbacks in defense/aerospace industries and military base closures and a major drop in real estate construction. California's economy has been recovering and growing steadily stronger since the start of 1994, to the point where the State's economic growth is outpacing the rest of the nation. More than 300,000 nonfarm jobs were added in the State in 1996, while personal income grew by more than $55 billion. Another 380,000 jobs are expected to be created in 1997. The unemployment rate, while still higher than the national average, fell to the low 6% range in mid-1997, compared to over 10% at the worst of the recession.

California's economic expansion is being fueled by strong growth in high-technology industries, including computer software, electronics manufacturing and motion picture/television production; growth is also strong in business services, export trade, and manufacturing, with even the aerospace sector now showing increased employment. The State's economy is now much more balanced and diversified than it was during the 1980's. Nonresidential real estate construction has grown rapidly in response to the growth in the economy. Residential construction has been growing slowly since the depths of the recession, but remains much lower (as measured by annual new unit permits) than the late 1980's.

Population and Labor Force

The State's August 1, 1996 population of 32.4 million represented over 12 percent of the total United States population. The following table shows California's population data for 1980 and 1990 through 1996.

Population, 1980 and 1990-96

Year	California Population[a]	% Increase Over Preceding Period	United States Population[a]	% Increase Over Preceding Period	California as % of United States
1980	23,782,000	18.7[b]	227,225,000	11.4[b]	10.5
1990	29,944,000	25.9[b]	249,398,000	9.8[b]	12.0
1991	30,565,000	2.1	252,106,000	1.1	12.1
1992	31,188,000	2.0	255,011,000	1.2	12.2
1993	31,517,000	1.1	257,795,000	1.1	12.2
1994	31,790,000	0.9	260,372,000	1.0	12.2
1995	32,063,000	0.9	262,890,000	1.0	12.2
1996	32,383,000	1.0	265,284,000	0.9	12.2

[a]Population as of July 1.
[b]Increase over preceding decade.
SOURCE: U.S. Department of Commerce, Bureau of the Census; State of California, Department of Finance.

California's population is concentrated in metropolitan areas. As of the April 1, 1990 census, 96 percent resided in the 23 Metropolitan Statistical Areas in the State. As of July 1, 1996, the 5-county Los Angeles area accounted for 49 percent of the State's population, with 15.7 million residents, and the 10-county San Francisco Bay Area represented 21 percent, with a population of 6.7 million.

The following table presents civilian labor force data for the resident population, age 16 and over, for the years 1991 to 1996.

Labor Force 1991-96

	Labor Force Trends (Thousands)*			Unemployment Rate(%)	
Year	Labor Force	Employment	Unemployment	California	United States
1991	15,176	14,004	1,172	7.7	6.8
1992	15,404	13,973	1,431	9.3	7.5
1993	15,359	13,918	1,441	9.4	6.9
1994	15,450	14,122	1,328	8.6	6.1
1995	15,428	14,217	1,211	7.8	5.6
1996	15,596	14,470	1,126	7.2	5.4

*Figures as of March 31.
SOURCE: State of California, Employment Development Department.

Employment, Income and Retail Sales

The following table shows California's nonagricultural employment distribution and growth for 1980, 1990 and 1996.

Payroll Employment By Major Sector 1980, 1990 and 1996

	Employment (Thousands)			% Distribution of Employment		
Industry Sector	1980	1990	1996	1980	1990	1996
Mining	44	39	30	0.4	0.3	0.2
Construction	428	605	511	4.3	4.8	4.0
Manufacturing						
Nondurable goods	639	721	717	6.5	5.7	5.6
High Technology	615	686	498	6.2	5.4	3.9
Other Durable goods	764	690	638	7.8	5.4	5.0
Transportation and Utilities	546	624	642	5.5	4.9	5.0
Wholesale and Retail Trade	2,267	3,002	2,973	23.0	23.7	23.3
Finance, Insurance and Real Estate	623	825	733	6.3	6.5	5.7
Services	2,159	3,395	3,917	21.9	26.8	30.7
Government						
Federal	334	362	298	3.4	2.9	2.3
State and Local	1,430	1,713	1,819	14.5	13.5	14.2
TOTAL NONAGRICULTURAL	9,849	12,662	12,775	100	100	100

SOURCE: State of California, Employment Development Department and State of California, Department of Finance.

The following tables show California's total and per capita income patterns for selected years.

Total Personal Income, 1980, 1990-96

	California		United States		California
Year	Millions	% Change	Billions	% Change	% of U.S.
1980	$280,601	–	$2,279.2	–	12.3
1990	636,593	8.2*	4,774.0	6.7*	13.3
1991	651,224	2.3	4,950.8	3.7	13.2
1992	683,398	4.9	5,248.6	6.0	13.0
1993	697,911	2.1	5,471.1	4.2	12.8
1994[a]	715,923	2.6	5,739.9	4.9	12.5
1995	760,431	6.2	6,098.0	6.2	12.5
1996	810,129	6.5	n.a.	n.a.	n.a.

* Change from prior year.

[a] Reflects Northridge earthquake, which caused an estimated $15 billion drop in personal income.

Note: Omits income for government employees overseas.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

Per Capita Personal Income, 1980 and 1990-96

Year	California	% Change	United States	% Change	California % of U.S.
1980	$11,792	-	$10,029	-	117.6
1990	21,287	5.7*	19,142	5.6*	112.1
1991	21,411	0.6	19,636	2.6	109.0
1992	22,109	3.3	20,581	4.8	107.4
1993	22,356	1.1	21,224	3.1	105.3
1994[a]	22,778	1.9	22,047	3.9	103.3
1995	24,073	5.7	23,208	5.3	103.7
1996	25,017	3.9	n.a.	n.a.	n.a.

*Change from prior year
[a] Reflects Northridge earthquake, which caused an estimated $15 billion drop in personal income.
SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

According to the U.S. Department of Commerce, California accounted for 10.9 percent of all retail trade in the nation in 1996. The following table shows the retail sales of California and of the United States and total taxable sales for California.

Retail Sales, 1980 and 1990-96

	Total Retail Sales				Taxable Sales	
	California	Percent Change	United States	Percent Change	California	Percent Change
1980	$112.5	--	$ 957.4	--	$142.8	--
1990	237.4	5.3*	1,844.6	4.9*	281.8	3.6*
1991	231.0	(2.7)	1,855.9	0.6	270.8[(a)]	(3.9)
1992	231.5	0.2	1,951.6	5.2	272.4[(b)]	0.6
1993	232.4	0.4	2,072.8	6.2	272.1	(0.1)
1994	245.8	5.8	2,227.3	7.5	286.0	5.1
1995	254.2	3.4	2,324.0	4.3	301.0	5.2
1996	266.3	4.8	2,445.3	5.2	321.1	6.7

*Change from prior year.
(a) 1991 Taxable Sales includes base expansion. Estimated percent change on a comparable basis is -5.0.
(b) 1992 Taxable Sales includes base expansion. Estimated percent change on a comparable basis is -0.5.
SOURCE: Retail sales from U.S. Bureau of Census. Taxable sales from the State of California, Board of Equalization. Estimates from State of California, Department of Finance.

Organization of State Government

The State Constitution provides for three separate branches of government: the legislative, the judicial and the executive. The Constitution guarantees the electorate the right to make basic decisions, including amendments to the Constitution and local government charters. In addition, the State voters may directly influence State government through the initiative, referendum and recall processes.

California's Legislature consists of a forty-member Senate and an eighty-member Assembly. Assembly members are elected for two-year terms and Senators are elected for four-year terms. Assembly members are limited to three terms in office, and Senators to two terms, following 1990. The Legislature meets almost year round for a two-year session. The Legislature employs the Legislative Analyst, who provides reports on State finances, among other subjects. The Bureau of State Audits, headed by the State Auditor, an independent office since 1993, has annually issued an auditor's report based on an examination of the General Purpose Financial Statements of the State Controller, in accordance with generally accepted accounting principles.

The Governor is the chief executive officer of the State and is elected for a four-year term. The Governor presents the annual budget and traditionally presents an annual package of bills constituting a legislative program. In addition to the Governor, State law provides for seven other statewide elected officials in the executive branch. The current elected statewide officials, their party affiliation and the dates on which they were first elected, are as follows:

Office	Name	Party Affiliation	First Elected
Governor	Pete Wilson	Republican	1990
Lieutenant Governor	Gray Davis	Democrat	1994
Treasurer	Matt Fong	Republican	1994
Secretary of State	Bill Jones	Republican	1994
Attorney General	Daniel E. Lungren	Republican	1990
Controller	Kathleen Connell	Democrat	1994
Superintendent of Public Instruction	Delaine Eastin	Democrat	1994
Insurance Commissioner	Chuck Quackenbush	Republican	1994

The current term for each office expires in January 1999. Persons elected to statewide offices are limited to two terms in office.

The executive branch is principally administered through twelve major agencies and departments: Business, Transportation and Housing Agency, Child Development and Education Agency, Environmental Protection Agency, Department of Finance, Department of Food and Agriculture, Health and Welfare Agency, Department of Industrial Relations, Resources Agency, State and Consumer Services Agency, Department of Veterans Affairs, Trade and Commerce Agency and Youth and Adult Correctional Agency. In addition, some State programs come under boards and commissions, such as The Regents of the University of California, Public Utilities Commission, Franchise Tax Board and California Transportation Commission, which have authority over many functions of State government with the power to establish policy and promulgate regulations. The appointment of members of boards and commissions is usually shared by the Legislature and the Governor, and often includes ex officio members.

California has a comprehensive system of public higher education, comprising three sectors. The highest level is the University of California, which provides undergraduate, graduate and professional degrees to about 153,000 full-time equivalent students at nine campuses. The California State University system provides undergraduate and graduate degrees to about 258,000 full-time equivalent students at 23 campuses. The third sector consists of over 100 community colleges which provide associate degrees and continuing education to over 944,000 full-time equivalent students.

Employee Relations

As of March 1997, the State work force represented approximately 278,000 personnel years. Of the total, approximately 89,000 personnel years represented employees of institutions of higher education. Civil service employees who are subject to collective bargaining represent approximately 146,000 personnel years. The largest of the 21 bargaining units is the California State Employee's Association ("CSEA"), representing approximately 53 percent of those employees subject to collective bargaining.

The State Employer-Employee Relations Act, enacted in 1977, provides that State employees, defined as any civil service employee of the State and teachers under the jurisdiction of the Department of Education or the Superintendent of Public Instruction, and excluding certain other categories, have a right to form, join and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. Law enforcement employees have the right to be represented separately from other employees. The chosen employee organization has the right to represent its members, except that once an employee organization is recognized as the exclusive representative of a bargaining unit, only that organization may represent employees in that unit.

The scope of representation is limited to wages, hours and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization, and, if agreement is reached, to prepare a memorandum of understanding and present it to the Legislature for determination. The Governor and the recognized employee organization are authorized to agree mutually on the appointment of a mediator for the purpose of settling any disputes between the parties. Alternatively, either party could request the Public Employment Relations Board to appoint a mediator, in which case the costs of mediation would be paid by the Public Employment Relations Board.

Contracts between the State and the various employee bargaining units expire and are renegotiated periodically. To date, the State has not reached agreement with any of the 21 collective bargaining units to replace 20 agreements that expired June 30, 1995, and one agreement that expired June 30, 1997. Negotiations continue between the State and the collective bargaining units. The State has not experienced any major work stoppage in the last 10 years.

Employees' Retirement Systems

Major retirement benefit programs administered by the State are described below and in Note 22 to the State's Audited Financial Statements, in Exhibit 1 to Appendix A below. The information below has been provided by the retirement systems.

The Public Employees' Retirement System - The Public Employees' Retirement System ("PERS") was created by the Public Employees' Retirement Law. The Board of Administration of PERS administers the Public Employees' Retirement Fund (the "Fund") and five other benefit programs. The Fund is a pooling of assets of multiple defined benefit retirement plans. The benefits paid from these plans are based on members' years of service, age and final compensation. In addition, the plans provide disability and death benefits for eligible members and their beneficiaries.

PERS calculates two kinds of unfunded liabilities. The first is developed by the plan's funding method and is used in the determination of the employer contribution rates. The liabilities include benefits for all future service and the ledger assets are carried at actuarial (smoothed market) value. As of June 30, 1996, the State had a $2.95 billion unfunded liability, partially offset by an overfunding in the amount of $0.4 billion attributable to other PERS employers. The second is required by the Governmental Accounting Standards Board ("GASB") and represents a plan's fiscal soundness for use in external financial reporting. In this method, the liabilities include the benefits of employees' service to date but projected for future salary raises. Assets are carried at actuarial (smoothed market) value. Under this second method, the actuarial balance sheet of PERS on June 30, 1995 (the last date for which such calculation was made) reflected an overfunding in the amount of $3.1 billion. The State had a $1.5 billion unfunded liability, offset by an overfunding in the amount of $4.6 billion attributable to other PERS employers.

PERS has assets with a market value in excess of $118.5 billion as of June 30, 1997, an increase of $19 billion from June 30, 1996.

State Teachers' Retirement System - The State Teachers' Retirement System ("STRS") operates under the State Teachers' Retirement Law. STRS includes public school teachers in the State from pre-school through grade fourteen and certain other employees of the public school system. Membership is mandatory for all certificated employees meeting the eligibility requirements who are not members of PERS.

In general, STRS provides defined retirement benefits based on members' final compensation, age and term of service. In addition, the retirement program provides for benefits upon disability and to survivors upon the death of eligible members.

The most recent independent actuarial valuation of STRS was as of June 30, 1995. The results of that valuation showed a normal cost rate of 16.07 percent of payroll, a drop of 1.10 percent of payroll from the previous valuation. As of June 30, 1996, STRS had an accrued unfunded actuarial obligation of $848 million.

The member contributions and the employer contributions paid by local school districts total 16.00 percent of payroll, leaving an annual deficit in normal cost contributions of 0.07 percent of payroll. While the State is not the employer, the legislature sets the employer contribution rates. In addition, the State makes an annual General Fund appropriation to the Teachers' Retirement Fund in an amount adequate to fund the normal cost deficit and amortize the accrued unfunded obligation over the next 18 years. As a result of the settlement of a lawsuit over prior deficiencies in the State appropriation, the amount required by law is now transferred automatically without being subject to a Budget Act appropriation.

STRS has assets with a market value in excess of $74.9 billion as of June 30, 1997, an increase of $11.5 billion from June 30, 1996. STRS has a positive cash flow which is expected to continue through the next few decades and the State will not have to make additional contributions for the purpose of making benefit payments.

STATE INDEBTEDNESS

General

The State Treasurer is responsible for the sale of debt obligations of the State and its various authorities and agencies. The State has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper, lease-purchase debt and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

Capital Facilities Financing

General Obligation Bonds - The State Constitution prohibits the creation of general obligation indebtedness of the State unless a bond law is approved by a majority of the electorate voting at a general election or a direct primary. General obligation bond acts provide that debt service on general obligation bonds shall be appropriated annually from the General Fund and all debt service on general obligation bonds is paid from the General Fund. Under the State Constitution, debt service on general obligation bonds is the second charge to the General Fund after the application of moneys in the General Fund to the support of the public school system and public institutions of higher education. Certain general obligation bond programs receive revenues from sources other than the sale of bonds or the investment of bond proceeds.

As of September 1, 1997, the State had outstanding $17,598,206,000 aggregate principal amount of long-term general obligation bonds, and unused voter authorizations for the future issuance of $8,258,864,000 of long-term general obligation bonds. This figure consists of $3,599,514,000 of authorized commercial paper notes, described in the next paragraph (of which $1,203,320,000 had been issued), which had not yet been refunded by general obligation bonds, and $4,659,350,000 of other authorized but unissued general obligation debt. See the table "Authorized and Outstanding State Debt" below.

Commercial Paper Program - Pursuant to legislation enacted in 1995, voter approved general obligation indebtedness may be issued either as long-term bonds, or, for some but not all bond acts, as commercial paper notes. Commercial paper notes may be renewed or may be refunded by the issuance of long-term bonds. The State intends to issue long-term general obligation bonds from time to time to retire its general obligation commercial paper notes. Pursuant to the terms of the bank credit agreement presently in effect supporting the general obligation commercial paper program, not more than $1.75 billion of general obligation commercial paper notes may be outstanding at any time; this amount may be increased or decreased in the future. Commercial paper notes are deemed issued upon authorization by the respective Finance Committees, whether or not such notes are actually issued. As of September 1, 1997 the Finance Committees had authorized the issuance of up to $3,599,514,000 of commercial paper notes; as of that date $1,203,320,000 aggregate principal amount of general obligation commercial paper notes was actually issued and outstanding.

Lease-Purchase Debt - In addition to general obligation bonds, the State builds and acquires capital facilities through the use of lease-purchase borrowing. Under these arrangements, the State Public Works Board, another State agency or a joint powers authority issues bonds to pay for the construction of facilities such as office buildings, university buildings or correctional institutions. These facilities are leased to a State agency or the University of California under a long-term lease which provides the source of payment of the debt service on the lease-purchase bonds. In some cases, there is not a separate bond issue, but a trustee directly creates certificates of participation in the State's lease obligation, which are marketed to investors. Under applicable court decisions, such lease arrangements do not constitute the creation of "indebtedness" within the meaning of the Constitutional provisions which require voter approval. For purposes of this section of the Official Statement and the tables following, "lease-purchase debt" or "lease-purchase financing" means principally bonds or certificates of participation for capital facilities where the rental payments providing the security are a direct or indirect charge against the General Fund and also includes revenue bonds for a State energy efficiency program secured by payments made by various State agencies under energy service contracts. Certain of the lease-purchase financings are supported by special funds rather than the General Fund (see "STATE FINANCES--Sources of Tax Revenue"). The table does not include equipment leases or leases which were not sold, directly or indirectly, to the public capital market. The State had $6,098,659,797 General Fund-supported lease-purchase debt outstanding at September 1, 1997. The State Public Works Board, which is authorized to sell lease revenue bonds, had $1,352,143,000 authorized and unissued as of September 1, 1997. Also, as of that date certain joint powers authorities were authorized to issue approximately $422,500,000 of revenue bonds to be secured by State leases. See Notes 6 and 12 to the Financial Statements, Exhibit 1 to Appendix A, for additional information on State lease commitments.

Non-Recourse Debt - Certain State agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from State revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by private users of facilities financed by the revenue bonds. The enterprises and projects include transportation projects, various public works projects, public and private educational facilities (including the California State University and University of California systems), housing, health facilities and pollution control facilities. There are 16 agencies and authorities authorized to issue revenue obligations (excluding lease-purchase debt). State agencies and authorities had $19,089,988,871 aggregate principal amount of revenue bonds and notes which are non-recourse to the General Fund outstanding as of June 30, 1997, as further described in the table "State Agency Revenue Bonds and Conduit Financing" below.

Cash Flow Borrowings

As part of its cash management program, the State has regularly issued short-term obligations to meet cash flow needs. The following table shows the amount of revenue anticipation notes ("Notes") and revenue anticipation warrants ("Warrants") issued over the past five fiscal years. Between spring 1992 and summer 1994, the State had depended upon external borrowing, including borrowings extending into the subsequent fiscal year, to meet its cash needs, including repayment of maturing Notes and Warrants. The State did not have to resort to such cross-year borrowing during the 1995-96 or 1996-97 Fiscal Years. See "STATE FINANCES--State Warrants," "PRIOR FISCAL YEARS' FINANCIAL RESULTS" and "CURRENT STATE BUDGET" below.

The State issued $3.0 billion of revenue anticipation notes for the 1997-98 Fiscal Year on September 9, 1997, which mature on June 30, 1998.

State of California
Revenue Anticipation Notes and Warrants Issued
Fiscal Years 1993-94 to 1997-98

Fiscal Year	Type	Principal Amount (Billions)	Date Issued	Maturity Date
1993-1994	Notes Series A-B	$2.0	July 28, 1993	June 28, 1994
	Warrants Series A	1.2	February 23, 1994	December 21, 1994
	Warrants Series B	2.0	February 23, 1994	July 26, 1994
1994-1995	Warrants Series C-D	4.0	July 26, 1994	April 25, 1996
	Notes Series A-C	3.0	August 3, 1994	June 28, 1995
1995-1996	Notes	2.0	April 25, 1996	June 28, 1996
1996-1997	Notes Series A-C	3.0	August 6, 1996	June 30, 1997
1997-1998	Notes	3.0	September 9, 1997	June 30, 1998

SOURCE: State of California, Office of the Treasurer.

Authorized and Outstanding State Debt

The tables which follow provide information on outstanding State debt, authorized but unissued general obligation bonds and commercial paper notes, debt service requirements for State general obligation and lease-purchase bonds, and authorized and outstanding State revenue bonds. For purposes of these tables, "General Fund bonds," also known as "non-self liquidating bonds," are general obligation bonds expected to be paid from the General Fund without reimbursement from any other fund. Although the principal of general obligation commercial paper notes in the "non-self liquidating" category is legally payable from the General Fund, the State expects that principal of such commercial paper notes will be paid only from the issuance of new commercial paper notes or the issuance of long-term general obligation bonds to retire the commercial paper notes. Interest on "non-self liquidating" general obligation commercial paper notes is payable from the General Fund.

"Enterprise Fund bonds," also known as "self liquidating bonds," are general obligation bonds for which program revenues are expected to be sufficient to reimburse in full the General Fund for debt service payments, but any failure to make such a reimbursement does not affect the obligation of the State to pay principal and interest on the bonds from the General Fund.

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS
As of September 1, 1997
(Thousands)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding	CP Program Authorized (a)	Unissued (b)
GENERAL FUND BONDS (Non-Self Liquidating)					
California Earthquake Safety and Housing Rehabilitation Bond Act of 1988	6/7/88	$ 150,000	$ 95,520	$ n.a.	$ 0
California Library Construction and Renovation Bond Act of 1988	11/8/88	75,000	53,270	6,725	1,900
California Park and Recreational Facilities Act of 1984	6/5/84	370,000	227,455	n.a.	7,500
California Parklands Act of 1980	11/4/80	285,000	82,235	n.a.	0
California Safe Drinking Water Bond Law of 1976	6/8/76	175,000	75,635	n.a.	5,000
California Safe Drinking Water Bond Law of 1984	11/6/84	75,000	44,980	n.a.	1,500
California Safe Drinking Water Bond Law of 1986	11/4/86	100,000	75,370	n.a.	8,000
California Safe Drinking Water Bond Law of 1988	11/8/88	75,000	47,820	11,265	7,000
California Wildlife, Coastal, and Park Land Conservation Act of 1988	6/7/88	776,000	571,795	n.a.	39,980
Clean Air and Transportation Improvement Bond Act of 1990	6/5/90	1,990,000	951,000	238,420	624,300
Clean Water and Water Conservation Bond Law of 1978	6/6/78	375,000	101,250	n.a.	4,150
Clean Water and Water Reclamation Bond Law of 1988	11/8/88	65,000	43,835	12,505	0
Clean Water Bond Law of 1970	11/3/70	250,000	7,000	n.a.	0
Clean Water Bond Law of 1974	6/4/74	250,000	16,320	n.a.	0
Clean Water Bond Law of 1984	11/6/84	325,000	138,390	n.a.	0
Community Parklands Act of 1986	6/3/86	100,000	69,225	n.a.	0
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988	11/8/88	500,000	377,810	25,000	0
County Correctional Facility Capital Expenditure Bond Act of 1986	6/3/86	495,000	346,790	n.a.	2,000
County Jail Capital Expenditure Bond Act of 1981	11/2/82	280,000	136,525	n.a.	0
County Jail Capital Expenditure Bond Act of 1984	6/5/84	250,000	122,400	n.a.	0
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990	6/5/90	300,000	42,000	84,000	166,000
Fish and Wildlife Habitat Enhancement Act of 1984	6/5/84	85,000	48,670	n.a.	3,500
Hazardous Substance Cleanup Bond Act of 1984	11/6/84	100,000	46,600	n.a.	0
Higher Education Facilities Bond Act of 1986	11/4/86	400,000	248,900	n.a.	0
Higher Education Facilities Bond Act of 1988	11/8/88	600,000	420,155	4,705	7,000
Higher Education Facilities Bond Act of June 1990	6/5/90	450,000	327,880	14,500	7,000
Higher Education Facilities Bond Act of June 1992	6/2/92	900,000	718,195	59,420	46,700
Housing and Homeless Bond Act of 1988	11/8/88	300,000	120,920	n.a.	0
Housing and Homeless Bond Act of 1990	6/5/90	150,000	86,025	n.a.	0
Lake Tahoe Acquisitions Bond Act	8/2/82	85,000	51,175	n.a.	1,000

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS
(Continued)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding	CP Program Authorized (a)	Unissued (b)
New Prison Construction Bond Act of 1981	6/8/82	$ 495,000	$ 180,250	n.a.	$ 0
New Prison Construction Bond Act of 1984	6/5/84	300,000	127,500	n.a.	0
New Prison Construction Bond Act of 1986	11/4/86	500,000	325,650	n.a.	3,000
New Prison Construction Bond Act of 1988	11/8/88	817,000	584,610	7,600	8,400
New Prison Construction Bond Act of 1990	6/5/90	450,000	308,145	40,100	0
Passenger Rail and Clean Air Bond Act of 1990	6/5/90	1,000,000	697,825	107,900	0
Public Education Facilities Bond Act of 1996	3/26/96	3,000,000	407,825	1,757,605	830,000
1988 School Facilities Bond Act	11/8/88	800,000	523,615	45,000	0
1990 School Facilities Bond Act	6/5/90	800,000	574,065	34,745	0
1992 School Facilities Bond Act	11/3/92	900,000	725,936	65,094	0
Safe, Clean Reliable Water Supply Act of 1996	11/5/96	995,000	0	142,000	853,000
Seismic Retrofit Bond Act of 1996	3/26/96	2,000,000	50,005	801,995	1,148,000
School Building and Earthquake Bond Act of 1974	11/5/74 (c)	40,000	38,665	n.a.	0
School Facilities Bond Act of 1988	6/7/88	800,000	535,120	n.a.	0
School Facilities Bond Act of 1990	11/6/90	800,000	566,765	55,000	0
School Facilities Bond Act of 1992	6/2/92	1,900,000	1,539,560	65,000	0
Senior Center Bond Act of 1984	11/6/84	50,000	22,500	n.a.	0
State Beach, Park, Recreational and Historical Facilities Bonds	(d)	250,000	4,850	n.a.	0
State School Building Lease-Purchase Bond Law of 1982	11/2/82	500,000	155,925	n.a.	0
State School Building Lease-Purchase Bond Law of 1984	11/6/84	450,000	239,800	n.a.	0
State School Building Lease-Purchase Bond Law of 1986	11/4/86	800,000	515,000	n.a.	0
State, Urban, and Coastal Park Bond Act of 1976	11/2/76	280,000	25,135	n.a.	2,450
Water Conservation and Water Quality Bond Law of 1986	6/3/86	150,000	70,210	n.a.	57,000
Water Conservation Bond Law of 1988	11/8/88	60,000	31,245	20,935	3,000
Total General Fund Bonds		$ 28,468,000	$ 13,945,346	$ 3,599,514	$ 3,837,380
ENTERPRISE FUND BONDS (Self Liquidating)					
California Water Resources Development Bond Act of 1959	11/8/60	$ 1,750,000	$ 1,049,195	$ n.a.	$ 167,600
Harbor Development Bond Law of 1958	11/4/58	60,000	570	n.a.	0
State School Building Aid Bonds	(c) (d)	460,000	7,500	n.a.	0
Veterans Bonds	(d)	5,610,000	2,595,595	n.a.	654,370
Total Enterprise Fund Bonds		$ 7,880,000	$ 3,652,860	$ 0	$ 821,970
TOTAL GENERAL OBLIGATION BONDS		$ 36,348,000	$ 17,598,206	$ 3,599,514	$ 4,659,350

(a) Total commercial paper authorized to be issued by the respective Finance Committees. Of this total $1,203,320,000 is outstanding as of September 1, 1997. Pursuant to terms of the Finance Committee resolutions, no more than $1.75 billion of commercial paper can be outstanding at any one time. Bond acts marked "n.a." are not legally permitted to utilize commercial paper, or all bonds were issued before the commercial paper program began.

(b) Treats full commercial paper authorization as issued; see footnote (a).

(c) Pursuant to Prop 203, passed by the voters in the March 26, 1996 primary election, $40 million in bonds unissued at that time became general fund supported, while all previously issued bonds will remain under "State School Building Aid Bonds" as self-liquidating Enterprise Bonds.

(d) Various dates.

SOURCE: State of California, Office of the Treasurer

OUTSTANDING STATE DEBT
FISCAL YEARS 1992-93 THROUGH 1996-97
(Thousands)

	1992-93	1993-94	1994-95	1995-96	1996-97
Outstanding Debt(a)					
General Obligation Bonds					
General Fund (Non-Self Liquidating)	$ 13,337,721	$ 14,368,506	$ 14,903,326	$ 14,322,086	$ 14,250,536
Enterprise Fund (Self Liquidating)	4,302,655	4,028,865	4,171,775	3,934,630	3,699,060
Total	$ 17,640,376	$ 18,397,371	$ 19,075,101	$ 18,256,716	$ 17,949,596
Lease-Purchase Debt	3,997,183	5,096,508	5,565,162	5,845,237	6,175,044
Total Outstanding General Obligation Bonds and Lease-Purchase Debt	$ 21,637,559	$ 23,493,879	$ 24,640,263	$ 24,101,953	$ 24,124,640
Bond Sales During Fiscal Year					
Non-Self Liquidating General Obligation Bonds	$ 2,617,706	$ 2,042,665	$ 1,505,600	$ 620,810	$ 1,025,000
Self Liquidating General Obligation Bonds	$ -	$ 2,000	$ 386,930	$ 0	$ 0
Lease-Purchase Debt	$ 1,775,570	$ 1,765,400	$ 598,817	$ 779,575	$ 1,257,630
Debt Service(b)					
Non-Self Liquidating General Obligation Bonds	$ 1,472,581	$ 1,748,001	$ 1,901,265	$ 1,960,603	$ 1,946,333
Lease-Purchase Debt	$ 276,514	$ 364,543	$ 425,940	$ 482,751	$ 532,783
General Fund Receipts(b)	$ 42,757,910	$ 40,527,732	$ 44,547,812	$ 46,731,104	$ 49,831,217
Non-Self Liquidating General Obligation Bonds Debt Service as a Percentage of General Fund Receipts	3.44%	4.31%	4.27%	4.20%	3.91%
Lease-Purchase Debt Service as a Percentage of General Fund Receipts	0.65%	0.90%	0.96%	1.03%	1.07%
Population(c)	31,188,000	31,517,000	31,790,000	32,063,000	32,383,000
Non-Self Liquidating General Obligation Bonds Outstanding Per Capita	$ 427.66	$ 455.90	$ 468.81	$ 446.69	$ 440.06
Lease-Purchase Debt Outstanding Per Capita	$ 128.16	$ 161.71	$ 175.06	$ 182.30	$ 190.69
Personal Income(d)	$ 697,911,000	$ 715,923,000	$ 760,431,000	$ 810,129,000	$ 865,185,000
Non-Self Liquidating General Obligation Bonds Outstanding as Percentage of Personal Income	1.91%	2.01%	1.96%	1.77%	1.65%
Lease-Purchase Debt Outstanding as Percentage of Personal Income	0.57%	0.71%	0.73%	0.72%	0.71%

(a) As of last day of fiscal year
(b) Calculated on a cash basis; debt service costs of bonds issued in any fiscal year largely appear in subsequent fiscal year.
(c) As of July 1, the beginning of the fiscal year.
(d) Calendar year in which fiscal year ends.

SOURCES: Population and Personal Income: State of California, Department of Finance
Outstanding Debt, Bonds Sales During Fiscal Year and Debt Service: State of California, Office of the Treasurer.
General Fund Receipts: State of California, Office of the State Controller.

SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR GENERAL FUND GENERAL OBLIGATION BONDS(a)
(Non-Self Liquidating)
As of September 1, 1997

Fiscal Year Ending June 30	Current Debt Interest	Principal (b)	Total
1998	643,387,647.04	680,400,000.00	1,323,787,647.04 (c)
1999	810,234,879.98	964,485,000.00	1,774,719,879.98
2000	753,466,633.75	950,345,000.00	1,703,811,633.75
2001	699,567,456.75	944,058,068.25	1,643,625,525.00
2002	633,185,393.82	987,850,000.00	1,621,035,393.82
2003	572,966,411.39	936,991,391.80	1,509,957,803.19
2004	511,917,361.25	862,850,000.00	1,374,767,361.25
2005	460,475,807.59	799,584,388.71	1,260,060,196.30
2006	407,076,800.00	736,120,000.00	1,143,196,800.00
2007	359,420,428.27	691,355,000.00	1,050,775,428.27
2008	317,545,182.94	674,678,078.31	992,223,261.25
2009	272,609,968.75	671,245,000.00	943,854,968.75
2010	229,073,333.75	614,605,000.00	843,678,333.75
2011	192,075,597.34	539,629,045.16	731,704,642.50
2012	155,409,373.80	396,085,000.00	551,494,373.80
2013	133,381,254.60	285,320,000.00	418,701,254.60
2014	118,663,209.64	212,665,000.00	331,328,209.64
2015	107,049,610.94	201,140,000.00	308,189,610.94
2016	95,919,642.24	199,450,000.00	295,369,642.24
2017	84,985,480.93	199,175,000.00	284,160,480.93
2018	74,211,161.85	198,740,000.00	272,951,161.85
2019	63,495,143.75	198,290,000.00	261,785,143.75
2020	52,800,875.00	197,825,000.00	250,625,875.00
2021	41,823,888.75	197,955,000.00	239,778,888.75
2022	31,074,846.25	182,635,000.00	213,709,846.25
2023	20,740,959.20	184,665,000.00	205,405,959.20
2024	11,708,668.09	112,420,000.00	124,128,668.09
2025	5,791,045.74	73,145,000.00	78,936,045 74
2026	2,370,980.00	34,140,000.00	36,510,980.00
2027	492,205.00	17,500,000.00	17,992,205.00
Total	$ 7,862,921,248.40	$ 13,945,345,972.23	$ 21,808,267,220.63

(a) Does not include commercial paper outstanding.

(b) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(c) Total represents the remaining debt service requirements from October 1, 1997 through June 30, 1998.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR ENTERPRISE FUND GENERAL OBLIGATION BONDS(a)

(Self Liquidating)

As of September 1, 1997

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal (b)	Total
1998	190,584,181.28	156,565,000.00	347,149,181.28 (c)
1999	230,309,643.65	195,450,000.00	425,759,643.65
2000	216,985,791.15	212,910,000.00	429,895,791.15
2001	202,196,496.25	222,690,000.00	424,886,496.25
2002	186,546,061.25	225,965,000.00	412,511,061.25
2003	170,583,751.35	225,925,000.00	396,508,751.35
2004	154,803,433.75	215,340,000.00	370,143,433.75
2005	139,493,329.75	212,835,000.00	352,328,329.75
2006	124,366,511.00	193,775,000.00	318,141,511.00
2007	110,611,351.01	179,230,000.00	289,841,351.01
2008	97,808,219.80	186,865,000.00	284,673,219.80
2009	85,574,785.00	180,240,000.00	265,814,785.00
2010	74,528,102.80	182,335,000.00	256,863,102.80
2011	58,955,152.00	116,815,000.00	175,770,152.00
2012	52,847,933.50	100,310,000.00	153,157,933.50
2013	47,289,061.00	100,805,000.00	148,094,061.00
2014	41,840,860.00	80,490,000.00	122,330,860.00
2015	38,202,822.50	103,240,000.00	141,442,822.50
2016	32,699,067.50	92,800,000.00	125,499,067.50
2017	27,672,222.50	84,330,000.00	112,002,222.50
2018	23,203,457.50	73,000,000.00	96,203,457.50
2019	19,157,997.50	66,000,000.00	85,157,997.50
2020	15,372,847.50	38,770,000.00	54,142,847.50
2021	13,146,862.50	31,395,000.00	44,541,862.50
2022	11,269,795.00	26,210,000.00	37,479,795.00
2023	9,613,635.00	26,035,000.00	35,648,635.00
2024	7,909,050.00	27,780,000.00	35,689,050.00
2025	6,091,355.00	29,585,000.00	35,676,355.00
2026	4,154,587.50	31,525,000.00	35,679,587.50
2027	2,144,868.75	33,645,000.00	35,789,868.75
Total	$ 2,395,963,233.29	$ 3,652,860,000.00	$ 6,048,823,233.29

(a) Does not include commercial paper outstanding.

(b) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(c) Total represents the remaining debt service requirements from October 1, 1997 through June 30, 1998.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR LEASE-PURCHASE DEBT
As of September 1, 1997

Fiscal Year Ending June 30	Current Debt Interest	Current Debt Principal (a)	Current Debt Total
1998	$ 285,747,753.66	$ 146,865,000.00	$ 432,612,753.66 (b)
1999	324,292,240.65	244,385,400.38	568,677,641.03
2000	312,030,429.72	265,109,962.79	577,140,392.51
2001	299,032,729.81	284,884,019.75	583,916,749.56
2002	285,432,256.71	262,840,773.02	548,273,029.73
2003	274,962,547.28	262,346,118.58	537,308,665.86
2004	260,878,650.24	272,881,386.24	533,760,036.48
2005	247,881,591.10	285,084,507.20	532,966,098.30
2006	230,160,316.58	302,687,554.60	532,847,871.18
2007	218,893,658.86	253,788,920.44	472,682,579.30
2008	202,146,297.95	259,226,787.98	461,373,085.93
2009	191,926,952.89	278,742,732.44	470,669,685.33
2010	171,248,055.27	264,491,633.76	435,739,689.03
2011	146,089,359.57	273,860,000.00	419,949,359.57
2012	131,414,248.51	254,080,000.00	385,494,248.51
2013	117,736,661.21	258,865,000.00	376,601,661.21
2014	103,952,418.31	257,875,000.00	361,827,418.31
2015	87,462,780.06	272,670,000.00	360,132,780.06
2016	73,065,062.43	248,670,000.00	321,735,062.43
2017	59,787,944.85	248,460,000.00	308,247,944.85
2018	47,058,201.51	257,585,000.00	304,643,201.51
2019	34,431,286.52	210,210,000.00	244,641,286.52
2020	20,435,303.84	183,740,000.00	204,175,303.84
2021	11,847,998.75	120,570,000.00	132,417,998.75
2022	5,147,568.13	92,150,000.00	97,297,568.13
2023	1,884,767.51	31,345,000.00	33,229,767.51
2024	271,065.63	2,515,000.00	2,786,065.63
2025	93,267.50	2,730,000.00	2,823,267.50
Total	$ 4,145,311,415.05	$ 6,098,659,797.18	$ 10,243,971,212.23

(a) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(b) Total represents the remaining debt service requirements from October 1, 1997 through June 30, 1998.

SOURCE: State of California, Office of the Treasurer.

STATE PUBLIC WORKS BOARD AND
OTHER LEASE-PURCHASE FINANCING
OUTSTANDING ISSUES
As of September 1, 1997

Name of Issue		Outstanding
GENERAL FUND SUPPORTED ISSUES:		
State Public Works Board		
California Community Colleges	$	666,175,000
Department of Corrections *		2,765,818,684
Energy Efficiency Program (Various State Agencies) (a)		150,600,000
The Regents of The University of California * (b)		1,016,501,113
Trustees of The California State University		620,105,000
Various State Office Buildings		299,630,000
Total State Public Works Board Financing	$	**5,518,829,797**
Other Lease-Purchase Issues		
Capitol Area Development Authority (State of California Department of General Services Lease)	$	6,285,000
Franchise Tax Board Refunding Certificates of Participation (California Franchise Tax Board Building)		32,560,000
Los Angeles State Building Authority (State of California Department of General Services Lease)		171,315,000
Redevelopment Agency of the City of Riverside (State of California Department of General Services Lease)		29,115,000
San Francisco State Building Authority (State of California Department of General Services Lease)		340,555,000
Total Other Lease-Purchase Issues	$	**579,830,000**
Total General Fund Supported Issues	$	**6,098,659,797**
SPECIAL FUND SUPPORTED ISSUES:		
East Bay State Building Authority Certificates of Participation (State of California Department of Transportation) *	$	92,905,101
San Bernardino Joint Powers Financing Authority (State of California Department of Transportation)		63,755,000
San Francisco State Building Authority (State of California Department of General Services Lease) (c)		56,495,000
Total Special Fund Supported Issues	$	**213,155,101**
TOTAL	$	**6,311,814,898**

* Includes the initial value of capital appreciation bonds rather than the accreted value.

(a) This program is self-liquidating based on energy cost savings.

(b) The Regents' obligations to the State Public Works Board are payable from lawfully available funds of The Regents which are held in The Regents' treasury funds and are separate from the State General Fund. A portion of The Regents' annual budget is derived from General Fund appropriations.

(c) The sole tenant is the California Public Utilities Commission

SOURCE: State of California, Office of the Treasurer.

STATE AGENCY REVENUE BONDS
AND CONDUIT FINANCING
For the quarter ending June 30, 1997

Issuing Agency	**Outstanding(a)**
State Programs Financing:	
California State University	$ 347,928,000
California Transportation Commission	50,405,000
Department of Water Resources	2,379,125,000
The Regents of the University of California	2,435,570
Trade and Commerce Agency	6,655,000
Housing Financing:	
California Housing Finance Agency	5,100,231,958
Veterans Revenue Debenture	327,580,000
Conduit Financing:	
California Alternative Energy and Advanced Transportation Financing Authority	84,150,000
California Economic Development Financing Authority	113,105,000
California Educational Facilities Authority	1,543,739,288
California Health Facilities Financing Authority	4,583,399,055
California Passenger Rail Financing Commission	--
California Pollution Control Financing Authority	4,501,220,000
California School Finance Authority	16,645,000
California Student Loan Authority	30,260,000
California Urban Waterfront Area Restoration Financing Authority	3,110,000
TOTAL	**$ 19,089,988,871**

(a) Total Outstanding does not include defeased bonds and includes the accreted values for capital appreciation bonds.

SOURCE: State of California, Office of the Treasurer.

STATE FINANCES

The Budget Process

The State's fiscal year begins on July 1 and ends on June 30. The State operates on a budget basis, using a modified accrual system of accounting, with revenues credited in the period in which they are collected and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under State law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues and balances available from prior fiscal years. Following the submission of the Governor's Budget, the Legislature takes up the proposal.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of the annual expenditure authorizations is the Budget Act as approved by the Legislature and signed by the Governor. The Budget Act must be approved by a two-thirds majority vote of each House of the Legislature. The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Bills containing appropriations (except for K-14 education) must be approved by a two-thirds majority vote in each House of the Legislature and be signed by the Governor. Bills containing K-14 education appropriations only require a simple majority vote. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution.

Funds necessary to meet an appropriation need not be in the State Treasury at the time such appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

The General Fund

The moneys of the State are segregated into the General Fund and approximately 800 Special Funds, including Bond, Trust and Pension Funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of State moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the State. For additional financial data relating to the General Fund, see Exhibits 1 and 2 to this Appendix A. The General Fund may be expended as a consequence of appropriation measures enacted by the Legislature and approved by the Governor, as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

The Special Fund for Economic Uncertainties

The Special Fund for Economic Uncertainties ("SFEU") is funded with General Fund revenues and was established to protect the State from unforeseen revenue reductions and/or unanticipated expenditure increases. Amounts in the SFEU may be transferred by the State Controller as necessary to meet cash needs of the General Fund. The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund.

The legislation creating the SFEU contains a continuous appropriation from the General Fund authorizing the State Controller to transfer to the SFEU, as of the end of each fiscal year, the lesser of (i) the unencumbered balance in the General Fund and (ii) the difference between the State's "appropriations subject to limitation" for the fiscal year then ended and its "appropriations limit" as defined in Section 8 of Article XIII B of the State Constitution and established in the Budget Act for that fiscal year, as jointly estimated by the State's Legislative Analyst's Office and the Department of Finance. For a further description of Article XIII B, see "State Appropriations Limit" below. In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes.

The SFEU had not carried a positive balance on a budget basis for several years prior to 1996-97. The 1997-98 Fiscal Year Budget Act reflects a balance of $112 million in the SFEU.

Inter-Fund Borrowings

Inter-fund borrowing has been used for many years to meet temporary imbalances of receipts and disbursements in the General Fund. As of June 30, 1997, the General Fund had outstanding loans from the SFEU and Special Funds in the amount of $1.190 billion.

In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the Pooled Money Investment Board (the "PMIB," consisting of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in Special Funds to the General Fund from such Special Funds, as determined by the PMIB. All money so transferred must be returned to the Special Fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made from a Special Fund which will interfere with the objective for which such Special Fund was created, or from certain specific funds. When moneys transferred to the General Fund in any fiscal year from any Special Fund pursuant to the inter-fund borrowing mechanism exceed ten percent of the total additions to surplus available for appropriation as shown in the statement of operations of the preceding fiscal year as set forth in the annual report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the Pooled Money Investment Account.

Although any determination of whether a proposed borrowing from one of the Special Funds is permissible, any such determination must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The Attorney General of the State has identified certain criteria relevant to such a determination. For instance, amounts in the Special Funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the Special Funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education and the payment of debt service on general obligation bonds of the State. Any reduction in internal borrowable resources may increase the State's reliance on external borrowing to meet its cash flow requirements.

The following chart shows General Fund internal borrowable resources on June 30 of each of the Fiscal Years 1993-94 through 1996-97 and estimates for 1997-98:

General Fund Internal Borrowable Resources
(Cash Basis)
(Millions)

	June 30,				
	1994	**1995**	**1996**	**1997**	**1998**
Available Internal Borrowable Resources	$6,500.4	$5,376.0	$5,211.0	$6,242.2	$6,082.9
Outstanding Loans					
From Special Fund for Economic Uncertainties	-0-	-0-	20.3	281.2*	112.0
From Special Funds and Accounts	4,015.0	-0-	1,433.7	909.2	2,570.5
Total Outstanding Internal Loans	4,015.0	-0-	1,454.0	1,190.4	2,682.5
Unused Internal Borrowable Resources†	$2,485.4	$5,376.0	$3,757.0	$5,051.8	$3,400.4

* Department of Finance estimates are slightly different because they are made using the budgetary basis of accounting. See "CURRENT STATE BUDGET" below.

† In addition, the State had external borrowings represented by Revenue Anticipation Warrants, in the following amounts at the following dates: June 30, 1994: $3.2 billion; June 30, 1995: $4.0 billion. See "STATE INDEBTEDNESS–Cash Flow Borrowings."

SOURCE: State of California, Office of the State Controller. Information for the Fiscal Years ended June 30, 1994 through 1997 are actual figures. For the year ending June 30, 1998, this figure was estimated as of August 21, 1997.

Investment of Funds

Moneys on deposit in the State's Centralized Treasury System are invested by the Treasurer in the Pooled Money Investment Account (the "PMIA"). As of July 31, 1997, the PMIA held approximately $18.2 billion of State moneys, and $10.8 billion of moneys invested for about 2,500 local governmental entities through the Local Agency Investment Fund ("LAIF"). The assets of the PMIA as of July 31, 1997 are shown in the following table:

Analysis of the Pooled Money Investment Account Portfolio

Type of Security	Amount (Millions)	Percent of Total
U.S. Treasury Bills and Notes	$ 6,997.8	24.1%
Commercial Paper (corporate)	6,677.9	23.0
Certificates of Deposits	5,666.5	19.5
Corporate Bonds	1,595.6	5.5
Federal Agency Securities	1,989.2	6.8
Bankers Acceptances	867.7	3.0
Bank Notes	874.1	3.0
Loans Per Government Code	3,936.3	13.6
Time Deposits	680.3	2.3
Repurchases	50.0	.2
Reverse Repurchases	(290.0)	(1.0)
	$29,044.8*	100.0%

*Total may not add due to rounding.
SOURCE: State of California, Office of the Treasurer.

The State's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the Pooled Money Investment Board (consisting of the State Treasurer, the State Controller and the Director of Finance). The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment.

The average life of the investment portfolio of the PMIA as of July 31, 1997 was 222 days.

State Warrants

No money may be drawn from the State Treasury except upon a warrant duly issued by the State Controller. The State Controller is obligated to draw every warrant on the fund out of which it is payable for the payment of money directed by State law to be paid out of the State Treasury; however, a warrant may not be drawn unless authorized by law and unless unexhausted specific appropriations provided by law are available to meet it. State law provides two methods for the State Controller to respond if the General Fund has insufficient "Unapplied Money" available to pay a warrant when it is drawn, referred to generally as "registered warrants" and "reimbursement warrants." "Unapplied Money" consists of money in the General Fund for which outstanding warrants have not already been drawn and which would remain in the General Fund if all outstanding warrants previously drawn and then due were paid. Unapplied Money may include moneys transferred to the General Fund from the SFEU and internal borrowings from the Special Funds (to the extent permitted by law).

If a warrant is drawn on the General Fund for an amount in excess of the amount of Unapplied Money in the General Fund, after deducting from such Unapplied Money the amount, as estimated by the State Controller, required by law to be set apart for obligations having priority over obligations to which such warrant is applicable, the warrant must be registered by the State Treasurer on the reverse side as not paid because of the shortage of funds in the General Fund. The State Controller then delivers such a "registered warrant" to persons or entities (e.g., employees, suppliers and local governments) otherwise entitled to receive payments from the State. A registered warrant bears interest at a rate designated by the PMIB up to a maximum of 5 percent per annum. Registered warrants have no fixed maturity date, but are redeemed when the Controller, with the approval of the PMIB, determines there would be sufficient Unapplied Money in the General Fund. The State Controller notifies the State Treasurer, who publishes a notice that the warrants in question are payable.

In lieu of issuing individual registered warrants to numerous creditors, there is an alternative procedure whereby the Governor, upon request of the State Controller, may create a General Cash Revolving Fund in the State Treasury which may borrow from other State special funds to meet payments authorized by law. The State Controller may then issue "reimbursement warrants" at competitive bid to reimburse the General Cash Revolving Fund, thereby increasing cash resources for the General Fund to cover required payments. The General Cash Revolving Fund is created solely to facilitate the issuance of registered reimbursement warrants. Reimbursement warrants have a fixed maturity date, and must be paid by the State Treasurer on their maturity date from any Unapplied Money in the General Fund and available therefor.

See "PRIOR FISCAL YEARS' FINANCIAL RESULTS" below and "STATE INDEBTEDNESS--Short-Term Borrowings" above for a discussion of warrants issued by the State during the 1991-92 Fiscal Year and thereafter to meet the State's cash needs.

Welfare Reform

Congress passed and the President signed (on August 22, 1996) the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193, the "Law") making a fundamental reform of the nation's welfare system. Among many provisions, the Law includes: (i) conversion of Aid to Families with Dependent Children from an entitlement program to a block grant titled Temporary Assistance for Needy Families (TANF), with lifetime time limits on TANF recipients, work requirements and other changes; (ii) provisions denying certain federal welfare and public benefits to legal noncitizens (this provision was recently changed by a federal law), allowing states to elect to deny additional benefits (including TANF) to legal noncitizens, and generally denying almost all benefits to illegal immigrants; and (iii) changes in the Food Stamp program, including reducing maximum benefits and imposing work requirements.

As part of the 1997-98 Budget Act legislative package, the Legislature and Governor agreed on a comprehensive reform of the State's public assistance programs to implement the new federal Law. The new basic State welfare program is called California Work Opportunity and Responsibility to Kids Act ("CalWORKs"), which replaces the former Aid to Families with Dependent Children (AFDC) and Greater Avenues to Independence (GAIN) programs effective January 1, 1998. Consistent with the federal Law, CalWORKs contains new time limits on receipt of welfare aid, both lifetime as well as for any current spell on aid. The centerpiece of CalWORKs is the linkage of eligibility to work participation requirements. Administration of the new Welfare-to-Work programs will be largely at the county level, and counties are given financial incentives for success in this program.

Although the longer-term impact of the new federal Law and CalWORKs cannot be determined until there has been some experience, the State does not presently anticipate that these new programs will have any adverse financial impact on the General Fund. Overall TANF grants from the federal government are expected to equal or exceed the amounts the State would have received under the old AFDC program.

Local Governments

The primary units of local government in California are the counties, ranging in population from 1,200 (Alpine) to over 9,300,000 (Los Angeles). Counties are responsible for the provision of many basic services, including indigent health care, welfare, courts, jails and public safety in unincorporated areas. There are also about 480 incorporated cities, and thousands of other special districts formed for education, utility and other services. The fiscal condition of local governments has been constrained since the enactment of "Proposition 13" in 1978, which reduced and limited the future growth of property taxes, and limited the ability of local governments to impose "special taxes" (those devoted to a specific purpose) without two-thirds voter approval.

Counties, in particular, have had fewer options to raise revenues than many other local government entities, and have been required to maintain many services. The entire statewide welfare system has been changed in response to the change in federal welfare law enacted in 1996 (see "Welfare Reform" above). Under the CalWORKs program, counties are given flexibility to develop their own plans, consistent with State law, to implement Welfare-to-Work and to administer many of its elements. Counties are also given financial incentives if, at the individual county level or statewide, the CalWORKs program produces savings associated with specified Welfare-to-Work outcomes; counties may also suffer penalties for failing to meet federal standards. Under CalWORKs, counties will still be required to provide "general assistance" aid to certain persons who cannot obtain welfare from other programs. It is yet not known how the CalWORKs system will affect county finances in the long run.

In the aftermath of Proposition 13, the State provided aid from the General Fund to make up some of the loss of property tax moneys, including taking over the principal responsibility for funding local K-12 schools and community colleges. Under the pressure of the recent recession, the Legislature has eliminated the remnants of this post-Proposition 13 aid to entities other than K-14 education districts, although it has also provided additional funding sources (such as sales taxes) and reduced mandates for local services. See "PRIOR FISCAL YEARS' FINANCIAL RESULTS" below. Many counties continue to be under severe fiscal stress. While such stress has in recent years most often been experienced by smaller, rural counties, larger urban counties, such as Los Angeles, have also been affected. Orange County implemented significant reductions in services and personnel, and continues to face fiscal constraints in the aftermath of its bankruptcy, which had been caused by large investment losses in its pooled investment funds.

On November 5, 1996, voters approved Proposition 218, entitled the "Right to Vote on Taxes Act," which incorporates new Articles XIIIC and XIIID into the California Constitution. These new provisions enact limitations on the ability of local government agencies to impose or raise various taxes, fees, charges and assessments without voter approval. Certain "general taxes" imposed after January 1, 1995 must be approved by voters in order to remain in effect. In addition, Article XIIIC clarifies the right of local voters to reduce taxes, fees, assessments or charges through local initiatives.

Proposition 218 does not affect the State or its ability to levy or collect taxes. There are a number of ambiguities concerning the Proposition and its impact on local governments and their bonded debt which will require interpretation by the courts or the Legislature. The Legislative Analyst estimated that enactment of Proposition 218 would reduce local government revenues statewide by over $100 million a year, and that over time, annual revenues to local government would be reduced by several hundred million dollars.

State Appropriations Limit

The State is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the "Appropriations Limit"). The Appropriations Limit does not restrict appropriations to pay debt service on the Bonds or other voter-authorized bonds.

Article XIII B prohibits the State from spending "appropriations subject to limitation" in excess of the Appropriations Limit. "Appropriations subject to limitation," with respect to the State, are authorizations to spend "proceeds of taxes," which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed "the cost reasonably borne by that entity in providing the regulation, product or service," but "proceeds of taxes" exclude most state subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not "proceeds of taxes," such as reasonable user charges or fees and certain other non-tax funds.

Not included in the Appropriations Limit are appropriations for the debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes). The Appropriations Limit may also be exceeded in cases of emergency.

The State's Appropriations Limit in each year is based on the limit for the prior year, adjusted annually for changes in State per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government. The measurement of change in population is a blended average of statewide overall population growth, and change in attendance at local school and community college ("K-14") districts. The Appropriations Limit is tested over consecutive two-year periods. Any excess of the aggregate "proceeds of taxes" received over such two-year period above the combined Appropriations Limits for those two years is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor's Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the State's Appropriations Limit for the past four fiscal years and the current fiscal year.

State Appropriations Limit
(Millions)

	Fiscal Years				
	1993-94	1994-95	1995-96	1996-97	1997-98
State Appropriations Limit	$ 36,599	$ 37,544	$ 39,309	$ 42,002	$ 44,778
Appropriations Subject to Limit	(29,855)	(31,621)	(34,166)	(35,304)	(38,021)
Amount (Over)/Under Limit	$ 6,744	$ 5,933	$ 5,143	$ 6,698	$ 6,757

SOURCE: State of California, Department of Finance.

Proposition 98

On November 8, 1988, voters of the State approved Proposition 98, a combined initiative constitutional amendment and statute called the "Classroom Instructional Improvement and Accountability Act." Proposition 98 changed State funding of public education below the university level and the operation of the State Appropriations Limit, primarily by guaranteeing K-14 schools a minimum share of General Fund revenues. Under Proposition 98 (as modified by Proposition 111, which was enacted on June 5, 1990), K-14 schools are guaranteed the greater of (a) in general, a fixed percent of General Fund revenues ("Test 1"), (b) the amount appropriated to K-14 schools in the prior year, adjusted for changes in the cost of living (measured as in Article XIII B by reference to State per capita personal income) and enrollment ("Test 2"), or (c) a third test, which would replace Test 2 in any year when the percentage growth in per capita General Fund revenues from the prior year plus one half of one percent is less than the percentage growth in State per capita personal income ("Test 3"). Under Test 3, schools would receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus an additional small adjustment factor. If Test 3 is used in any year, the difference between Test 3 and Test 2 would become a "credit" to schools which would be the basis of payments in future years when per capita General Fund revenue growth exceeds per capita personal income growth. Legislation adopted prior to the end of the 1988-89 Fiscal Year, implementing Proposition 98, determined the K-14 schools' funding guarantee under Test 1 to be 40.3 percent of the General Fund tax revenues, based on 1986-87 appropriations. However, that percent has been adjusted to approximately 35 percent to account for a subsequent redirection of local property taxes, since such redirection directly affects the share of General Fund revenues to schools.

Proposition 98 permits the Legislature by two-thirds vote of both houses, with the Governor's concurrence, to suspend the K-14 schools' minimum funding formula for a one-year period. Proposition 98 also contains provisions transferring certain State tax revenues in excess of the Article XIII B limit to K-14 schools (see "STATE FINANCES--State Appropriations Limit" above).

During the recent recession, General Fund revenues for several years were less than originally projected, so that the original Proposition 98 appropriations turned out to be higher than the minimum percentage provided in the law. The Legislature responded to these developments by designating the "extra" Proposition 98 payments in one year as a "loan" from future years' Proposition 98 entitlements, and also intended that the "extra" payments would not be included in the Proposition 98 "base" for calculating future years' entitlements. By implementing these actions, per-pupil funding from Proposition 98 sources stayed almost constant at approximately $4,200 from Fiscal Year 1991-92 to Fiscal Year 1993-94.

In 1992, a lawsuit was filed, called *California Teachers' Association v. Gould*, which challenged the validity of these off-budget loans. The settlement of this case, finalized in July, 1996, provides, among other things, that both the State and K-14 schools share in the repayment of prior years' emergency loans to schools. Of the total $1.76 billion in loans, the State will repay $935 million by forgiveness of the amount owed, while schools will repay $825 million. The State share of the repayment will be reflected as an appropriation above the current

Proposition 98 base calculation. The schools' share of the repayment will count as appropriations that count toward satisfying the Proposition 98 guarantee, or from "below" the current base. Repayments are spread over the eight-year period of 1994-95 through 2001-02 to mitigate any adverse fiscal impact.

Substantially increased General Fund revenues, above initial budget projections, in the fiscal years 1994-95 and thereafter have resulted or will result in retroactive increases in Proposition 98 appropriations from subsequent fiscal years' budgets. Because of the State's increasing revenues, per-pupil funding at the K-12 level has increased by about 22% from the level in place from 1991-92 through 1993-94, and is estimated at about $5,150 per ADA in 1997-98. A significant amount of the "extra" Proposition 98 monies in the last few years have been allocated to special programs, most particularly an initiative to allow each classroom from grades K-3 to have no more than 20 pupils by the end of the 1997-98 school year. There are also new initiatives for reading skills and to upgrade technology in high schools. See "PRIOR FINANCIAL RESULTS - 1995-96 and 1996-97 Fiscal Years" and "CURRENT STATE BUDGET - 1997-98 Fiscal Year" for a further discussion of education funding.

Sources of Tax Revenue

The following is a summary of the State's major revenue sources. Further information on State revenues is contained under "CURRENT STATE BUDGET" and "STATE FINANCES--Recent Tax Receipts" below.

Personal Income Tax

The California personal income tax, which in 1995-96 contributed about 45 percent of General Fund revenues, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions). The tax is progressive with rates ranging from 1 to 9.3 percent. Personal, dependent and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax ("AMT") which is much like the federal AMT. Legislation enacted in July 1991 added two new marginal tax rates, at 10 percent and 11 percent, effective for tax years 1991 through 1995. After 1995, the maximum personal income tax rate returned to 9.3 percent, and the AMT rate dropped from 8.5 percent to 7 percent.

The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income.

Sales Tax

The sales tax is imposed upon retailers for the privilege of selling tangible personal property in California. Sales tax accounted for about 34 percent of General Fund revenue in 1995-96. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft.

The breakdown of the 7.25 percent rate currently imposed on a statewide basis is:

- 5.00 percent represents the State General Fund tax rate.
- 2.00 percent is dedicated to cities and counties.
- 0.25 percent is dedicated to county transit systems.

Legislation in July 1991 raised the sales tax rate by 1.25 percent to its current level. Of this amount, 0.25 percent was added to the General Fund tax rate, and the balance was dedicated to cities and counties. One-half percent was a permanent addition to counties, but with the money earmarked to trust funds to pay for health and welfare programs whose administration was transferred to counties. Another 0.5 percent of the State General Fund tax rate that was scheduled to terminate after June 30, 1993 was extended until December 31, 1993 and allocated to local agencies for public safety programs. Voters in a special election on November 2, 1993 approved a constitutional amendment to permanently extend this 0.5 percent sales tax for local public safety programs.

Currently, 0.25 percent of the State tax rate may be terminated upon certification by the Director of Finance that the balance in the budget reserve for two consecutive years will exceed 4 percent of General Fund revenues. The 0.25 percent rate can be reinstated if the Director of Finance subsequently determines that the reserve will not exceed 4 percent of General Fund revenues.

Bank and Corporation Tax

Bank and corporation tax revenues, which comprised about 13 percent of General Fund revenue in 1995-96, are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at a 8.84 percent rate on profits for income years beginning on or after January 1, 1997. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations which do not do business in California but which derive income from California sources.

2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2.0 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.

3. The alternative minimum tax (AMT) is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 6.65 percent effective for income years beginning on or after January 1, 1997.

4. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

Insurance Tax

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other State and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.50 percent, surplus lines and nonadmitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits. Insurance taxes comprised approximately 2.4 percent of General Fund revenues in 1995-96.

In November, 1988, voters approved Proposition 103, which mandated reductions and rebates for certain property and casualty insurance premiums. The measure also directed the State Board of Equalization to adjust the gross premiums tax rate to compensate for any resultant decrease in insurance tax revenue through the 1990 tax year. As a result, the State Board of Equalization increased the gross premiums tax rate from 2.35 percent to 2.37 percent for the 1989 tax year and to 2.46 percent for the 1990 tax year. For 1991 and beyond, the rate returned to 2.35 percent. Implementation of the offset rates used for Proposition 103 resulted in a lawsuit, which has now been settled. The Board of Equalization anticipates claims of $33 million from this case will be paid by the State.

In December, 1996, the California Earthquake Authority (CEA) was authorized to start selling homeowners' earthquake insurance. Earthquake policies written through the CEA are exempt from the gross premiums tax. It is expected that approximately 70 percent of the homeowners' earthquake policies written in the State will be underwritten by the CEA.

Other Taxes

Other General Fund major taxes and licenses include: Estate, Inheritance and Gift Taxes, Cigarette Taxes, Alcoholic Beverage Taxes, Horse Racing Revenues and trailer coach license fees. These other sources totaled approximately 2.6 percent of General Fund Revenues in the 1995-96 Fiscal Year.

Special Fund Revenues

The California Constitution, codes and statutes specify the uses of certain revenue. Such receipts are accounted for in various Special Funds. In general, Special Fund revenues comprise three categories of income:

1. Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.

2. Charges for special services to specific functions, including such items as business and professional license fees.

3. Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees accounted for about 60 percent of all Special Fund revenue in 1995-96. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. During the 1995-96 Fiscal Year, $7.7 billion was derived from the ownership or operation of motor vehicles. About $3.3 billion of this revenue was returned to local governments. The remainder was available for various State programs related to transportation and services to vehicle owners. These amounts (as well as those shown below in the table "Comparative Yield of State Taxes--All Funds") include the additional fees and taxes derived from the passage of Proposition 111 in June 1990.

On November 8, 1988, voters approved Proposition 99, which imposed, as of January 1, 1989, an additional 25 cents per pack excise tax on cigarettes, and a new, equivalent excise tax on other tobacco products. The initiative requires that funds from this tax be allocated to anti-tobacco education and research and indigent health services, and environmental and recreation programs. The Legislature, as part of the 1994-95 and 1995-96 Budget Acts, redirected a larger share of the Proposition 99 funds to indigent health care. These actions have been blocked by court orders, and are currently being litigated. See Note 20 to the Audited Financial Statements, Exhibit 1 to Appendix A. Legislation enacted in 1993 added an additional 2 cents per pack excise tax for the purpose of funding breast cancer research.

Recent Tax Receipts

The following table shows the trend of major General Fund and total taxes per capita and per $100 of personal income for the past nine years and the current and upcoming fiscal years.

Trend of State Taxes

Fiscal Year	Taxes per Capita(a) General Fund	Taxes per Capita(a) Total	Taxes per $100 of Personal Income General Fund	Taxes per $100 of Personal Income Total
1987-88	$1,126.67	$1,284.81	$6.19	$7.06
1988-89	1,255.49	1,430.39	6.51	7.42
1989-90	1,278.16	1,477.32	6.33	7.32
1990-91	1,229.90	1,454.58	5.79	6.84
1991-92	1,311.04	1,598.43	6.15	7.50
1992-93	1,256.80	1,546.43	5.74	7.06
1993-94	1,216.84	1,552.84	5.50	7.01
1994-95	1,292.83	1,639.92	5.74	7.28
1995-96	1,398.03	1,759.85	5.89	7.42
1996-97(b)	1,481.55	1,802.95	5.92	7.21
1997-98(b)	1,556.08	1,885.44	5.93	7.18

(a) Data reflect population figures benchmarked to the 1990 Census.
(b) Estimated. See "CURRENT STATE BUDGET—1997-98 Fiscal Year."
SOURCE: State of California, Department of Finance.

The following table gives the actual and estimated growth in revenues by major source for the last nine years and the current and upcoming fiscal years.

COMPARATIVE YIELD OF STATE TAXES—ALL FUNDS
1987-88 THROUGH 1997-98
(Modified Accrual Basis)
(Thousands)

Year Ending June 30	Sales and Use	Personal Income	Bank and Corporation(a)	Tobacco(b)	Inheritance, Estate and Gift(c)	Insurance(d)	Alcoholic Beverages(e)	Horse Racing(f)	Motor Vehicle Fuel(g)	Motor Vehicle Fees(h)
1988 . .	$11,650,531	$12,950,346	$4,776,388	$250,572	$304,148	$1,158,321	$128,734	$132,208	$1,293,254	$2,966,334
1989 . .	12,650,893	15,889,179	5,138,009	559,617	335,091	1,317,630	128,264	131,334	1,320,512	3,142,484
1990 . .	13,917,771	16,906,568	4,965,389	787,076	388,527	1,167,684	128,524	135,962	1,349,146	3,305,711
1991 . .	13,839,573	16,852,079	4,544,783	745,074	498,774	1,287,152	129,640	145,972	1,999,771	3,513,159
1992 . .	17,458,521(i)	17,242,816(j)	4,538,451	726,064	446,696	1,167,307	321,352	127,845	2,457,229	4,369,862
1993 . .	16,598,863(i)	17,358,751(j)	4,659,950	677,846	458,433	1,188,181	292,107	112,544	2,412,574	4,470,321
1994 . .	16,857,369	17,402,976(j)	4,809,273	664,322	552,139	1,196,921	275,797	116,263	2,547,633	4,518,795
1995 . .	17,758,933(k)	18,608,181(j)	5,685,618	674,727	595,238	998,868	268,957	107,605	2,685,731	4,749,594
1996 . .	19,088,313(k)	20,877,687(j)	5,862,420	666,779	659,338	1,131,737	269,227	104,158	2,757,289	5,009,319
1997(l) .	18,270,167	23,400,000	5,770,100	657,200	667,000	1,190,000	264,800	89,222	2,878,223	5,197,943
1998(l) .	19,292,914	25,522,000	6,028,000	645,800	695,000	1,219,000	262,000	81,927	2,946,063	5,470,444

(a) Includes the corporation income tax and, from 1989 through 1997, the unitary election fee.

(b) Proposition 99, of 1988, increased the cigarette tax to $0.35 per pack and added an equivalent tax to other tobacco products. The Breast Cancer Act added $0.02 per pack effective January 1, 1994.

(c) Proposition 6, of 1982, repealed the inheritance and gift taxes and imposed an estate tax equal to the maximum allowable Federal estate tax credit, effective for decedents dying on or after June 8, 1982.

(d) The conclusion of litigation resulted in additional revenue of $51 million in 1987-88, $178 million in 1988-89, $7 million in 1990-91, $5 million in 1991-92, and in refunds of $46 million in 1993-94, and $200 million in 1994-95.

(e) Alcoholic beverage excise taxes were significantly increased effective July 15, 1991.

(f) Beginning with 1988-89, includes revenues from satellite wagering which were not included in prior years.

(g) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel.

(h) Registration and weight fees, motor vehicle license fees and other fees.

(i) Reflects 0.5 percent temporary sales tax increase between July 1, 1991 and June 30, 1993, which was transferred to local governments after July 1, 1993.

(j) Reflects temporary increase in top marginal rate to 11 percent, which reverted to 9.3 percent for tax years after January 1, 1996.

(k) Includes "Realignment Portion" which is transferred to local governments.

(l) Estimated. See "CURRENT STATE BUDGET."

SOURCE:
1987-88 through 1995-96: State of California, Office of the State Controller.
1996-97 through 1997-98: State of California, Department of Finance.

State Expenditures

The following table summarizes the major categories of State expenditures, including both General Fund and Special Fund programs.

GOVERNMENTAL COST FUNDS
(Budgetary Basis)
Schedule of Expenditures by Function and Character
1991-92 to 1995-96 Fiscal Years
(Thousands)

	1991-92	1992-93	1993-94	1994-95	1995-96
Function					
Legislative, Judicial, Executive					
Legislative	$ 174,865	$ 170,061	$ 175,792	$ 180,769	$ 187,768
Judicial	893,281	756,527	616,862	635,916	704,112
Executive	566,642	556,620	564,997	653,583	691,264
State and Consumer Services	605,668	567,778	630,515	697,555	749,368
Business, Transportation and Housing					
Business and Housing	250,379	402,439	224,217	225,398	243,185
Transportation	3,228,453	3,177,866	3,363,335	3,188,749	3,334,648
Trade and Commerce	—	24,992	34,122	47,595	51,280
Resources	1,177,053	1,078,435	1,088,492	1,141,488	1,179,481
Environmental Protection	296,672	346,786	510,274	459,492	505,206
Health and Welfare	16,273,206	15,728,495	15,953,388	16,675,380	17,275,117
Correctional Programs	2,735,073	2,693,576	3,074,471	3,280,762	3,638,672
Education					
Education—K through 12	17,268,507	15,699,317	13,820,462	14,973,978	16,773,927
Higher Education	6,135,704	5,344,174	4,951,535	5,436,640	5,844,282
General Government					
General Administration	1,008,546	824,387	1,015,089	1,000,650	672,935
Debt Service	1,341,720	1,627,492	1,802,833	2,189,529	2,153,682
Tax Relief	834,392	811,558	473,707	480,430	474,179
Shared Revenues	3,017,429	3,113,325	3,162,558	3,188,090	3,346,240
Miscellaneous	(19,185)	(87,124)	(129,338)	(92,508)	202,158
Expenditure Adjustment for Encumbrances	(312,295)	154,566	(162,958)	694,288	(7,691)
Credits for Overhead Services by General Fund	(169,704)	(182,689)	(184,336)	(156,118)	(130,016)
Statewide Indirect Cost Recoveries	(24,919)	(37,432)	(35,399)	(31,132)	(48,730)
Total	$55,281,487	$52,771,149	$50,950,618	$54,870,534	$57,841,067
Character					
State Operations	$14,956,129	$14,657,902	$15,322,082	$16,403,401	$17,341,247
Local Assistance	40,146,513	37,696,530	35,166,791	37,680,952	39,973,320
Capital Outlay	178,845	416,717	461,745	786,181	526,500
Total	$55,281,487	$52,771,149	$50,950,618	$54,870,534	$57,841,067

SOURCE: State of California, Office of the State Controller.

PRIOR FISCAL YEARS' FINANCIAL RESULTS

Fiscal Years Prior to 1995-96

Pressures on the State's budget in the late 1980's and early 1990's were caused by a combination of external economic conditions and growth of the largest General Fund Programs -- K-14 education, health, welfare and corrections -- at rates faster than the revenue base. These pressures could continue as the State's overall population and school age population continue to grow, and as the State's corrections program responds to a "Three Strikes" law enacted in 1994, which requires mandatory life prison terms for certain third-time felony offenders. In addition, the State's health and welfare programs are in a transition period as a result of recent federal and State welfare reform initiatives.

As a result of these factors and others, and especially because a severe recession between 1990-94 reduced revenues and increased expenditures for social welfare programs, from the late 1980's until 1992-93, the State had a period of budget imbalance. During this period, expenditures exceeded revenues in four out of six years, and the State accumulated and sustained a budget deficit in its budget reserve, the Special Fund for Economic Uncertainties ("SFEU") approaching $2.8 billion at its peak at June 30, 1993. Between the 1991-92 and 1994-95 Fiscal Years, each budget required multibillion dollar actions to bring projected revenues and expenditures into balance, including significant cuts in health and welfare program expenditures; transfers of program responsibilities and funding from the State to local governments; transfer of about $3.6 billion in annual local property tax revenues from other local governments to local school districts, thereby reducing State funding for schools under Proposition 98; and revenue increases (particularly in the 1991-92 Fiscal Year budget), most of which were for a short duration.

Despite these budget actions, as noted, the effects of the recession led to large, unanticipated deficits in the budget reserve, the SFEU, as compared to projected positive balances. By the 1993-94 Fiscal Year, the accumulated deficit was so large that it was impractical to budget to retire it in one year, so a two-year program was implemented, using the issuance of revenue anticipation warrants to carry a portion of the deficit over the end of the fiscal year. When the economy failed to recover sufficiently in 1993-94, a second two-year plan was implemented in 1994-95, again using cross-fiscal year revenue anticipation warrants to partly finance the deficit into the 1995-96 fiscal year. See "STATE INDEBTEDNESS--Cash Flow Borrowings" above.

Another consequence of the accumulated budget deficits, together with other factors such as disbursement of funds to local school districts "borrowed" from future fiscal years and hence not shown in the annual budget, was to significantly reduce the State's cash resources available to pay its ongoing obligations. When the Legislature and the Governor failed to adopt a budget for the 1992-93 Fiscal Year by July 1, 1992, which would have allowed the State to carry out its normal annual cash flow borrowing to replenish its cash reserves, the State Controller issued registered warrants to pay a variety of obligations representing prior years' or continuing appropriations, and mandates from court orders. See "STATE FINANCES--State Warrants" above. Available funds were used to make constitutionally-mandated payments, such as debt service on bonds and warrants. Between July 1 and September 4, 1992, when the budget was adopted, the State Controller issued a total of approximately $3.8 billion of registered warrants.

For several fiscal years during the recession, the State was forced to rely on external debt markets to meet its cash needs, as a succession of notes and revenue anticipation warrants were issued in the period from June 1992 to July 1994, often needed to pay previously maturing notes or warrants. These borrowings were used also in part to spread out the repayment of the accumulated budget deficit over the end of a fiscal year, as noted earlier. The last and largest of these borrowings was $4.0 billion of revenue anticipation warrants which were issued in July, 1994 and matured on April 25, 1996. See "STATE INDEBTEDNESS--Cash Flow Borrowings" above.

1995-96 and 1996-97 Fiscal Years

With the end of the recession, and a growing economy starting in 1994, the State's financial condition improved markedly in the last two fiscal years, with a combination of better than expected revenues, slowdown in growth of social welfare programs, and continued spending restraint based on the actions taken in earlier years. The last of the recession-induced budget deficits was repaid, allowing the State's budget reserve (the SFEU) to post a positive cash balance for only the second time in the 1990's, totaling $281 million as of June 30, 1997. The State's cash position also returned to health, as cash flow borrowing was limited to $3 billion in 1996-97, and no deficit borrowing has occurred over the end of these last two fiscal years.

In each of these two fiscal years, the State budget contained the following major features:

1. Expenditures for K-14 schools grew significantly, as the new revenues were directed to school spending under Proposition 98. This new money allowed several new education initiatives to be funded, and raised K-12 per-pupil spending to around $4,900 by Fiscal Year 1996-97. See "STATE FINANCES - Proposition 98" above.

2. The budgets restrained health and welfare spending levels, holding to the reduced benefit levels enacted in earlier years, and attempted to reduce General Fund spending by calling for greater support from the federal government. The State also attempted to shift to the federal government a larger share of the cost of incarceration and social services for illegal aliens. Some of these efforts were successful, and federal welfare reform also helped, but as a whole the federal support never reached the levels anticipated when the budgets were enacted. These funding shortfalls were, however, filled by the strong revenue collections, which exceeded expectations.

3. General Fund support for the University of California and California State Universities grew by an average of 5.2 percent and 3.3 percent per year, respectively, and there were no increases in student fees.

4. General Fund support for the Department of Corrections grew as needed to meet increased prison population. No new prisons were approved for construction, however.

5. There were no tax increases, and starting January 1, 1997, there was a 5 percent cut in corporate taxes. The suspension of the Renter's Tax Credit, first taken as a cost-saving measure during the recession, was continued.

As noted, the economy grew strongly during these fiscal years, and as a result, the General Fund took in substantially greater tax revenues (around $2.2 billion in 1995-96 and $1.6 billion in 1996-97) than were initially planned when the budgets were enacted. These additional funds were largely directed to school spending as mandated by Proposition 98, and to make up shortfalls from reduced federal health and welfare aid. As a result, there was not any dramatic increase in budget reserves, although the accumulated budget deficit from the recession years was finally eliminated in the past fiscal year.

CURRENT STATE BUDGET

The discussion below of the 1997-98 Fiscal Year budget and the table under "Summary of State Revenues and Expenditures" below are based on estimates and projections of revenues and expenditures for the current fiscal year and must not be construed as statements of fact. These estimates and projections are based upon various assumptions which may be affected by numerous factors, including future economic conditions in the State and the nation, and there can be no assurance that the estimates will be achieved. See "CURRENT STATE BUDGET--Revenue and Expenditure Assumptions" below.

Periodic reports on revenues and expenditures during the fiscal year are issued by the Administration, the State Controller's Office and the Legislative Analyst's Office. The Department of Finance issues a monthly Bulletin which reports the most recent revenue receipts, comparing them to Budget projections, and reports on other current developments affecting the Budget. The Administration also formally updates its budget projections twice during each fiscal year, generally in January and May.

1997-98 Fiscal Year

Background

On January 9, 1997, the Governor released his proposed budget for the 1997-98 Fiscal Year (the "Proposed Budget"). The Proposed Budget estimated General Fund revenues and transfers of about $50.7 billion, and proposed expenditures of $50.3 billion, which would leave a budget reserve in the SFEU of about $550 million. The Proposed Budget included provisions for a further 10% cut in Bank and Corporation Taxes, which ultimately was not enacted by the Legislature.

At the time of the May Revision, released on May 14, 1997, the Department of Finance increased its revenue estimate for the upcoming fiscal year by $1.3 billion, in response to the continued strong growth in the State's economy. Budget negotiations continued into the summer, with major issues to be resolved including final agreement on State welfare reform, increase in State employee salaries and consideration of a tax cut proposed by the Governor.

In May, 1997, action was taken by the California Supreme Court in an ongoing lawsuit, *PERS v. Wilson*, described in "LITIGATION" below, which made final a judgment against the State requiring an immediate payment from the General Fund to the Public Employees Retirement Fund ("PERF") to make up certain deferrals in annual retirement fund contributions which had been legislated in earlier years for budget savings, and which the courts found to be unconstitutional. On July 30, 1997, following a direction from the Governor, the Controller transferred $1.235 billion from the General Fund to the PERF in satisfaction of the judgment, representing the principal amount of the improperly deferred payments from 1995-96 and 1996-97.

Fiscal Year 1997-98 Budget Act

Once the pension payment eliminated essentially all the "increased" revenue in the budget, final agreement was reached within a few weeks on the welfare package and the remainder of the budget. The Legislature passed the Budget Bill on August 11, 1997, along with numerous related bills to implement its provisions. On August 18, 1997, the Governor signed the Budget Act, but vetoed about $314 million of specific spending items, primarily in health and welfare and education areas from both the General Fund and Special Funds.

The Budget Act anticipates General Fund revenues and transfers of $52.5 billion (a 6.8 percent increase over the final 1996-97 amount), and expenditures of $52.8 billion (an 8.0 percent increase from the 1996-97 levels). (The expenditure figure assumes restoration of $48 million of welfare program savings which were contained in a bill vetoed by the Governor because of other provisions and also assumes enactment of legislation to restore $203 million of expenditures associated with education upon agreement by the Legislature and the Governor on a satisfactory education testing program; these bills were passed and await the Governor's signature.) On a budgetary basis, the budget reserve (SFEU) is projected to decrease from $408 million at June 30, 1997 to $112 million at June 30, 1998. The Budget Act also includes Special Fund expenditures of $14.4 billion (as against estimated Special Fund revenues of $14.0 billion), and $2.1 billion of expenditures from various Bond Funds. Following enactment of the Budget Act, the State will implement its normal annual cash flow borrowing program, issuing $3 billion of notes which mature on June 30, 1998.

The following are major features of the 1997-98 Budget Act:

1. For the second year in a row, the Budget contains a large increase in funding for K-14 education under Proposition 98, reflecting strong revenues which have exceeded initial budgeted amounts. Part of the nearly $1.75 billion in increased spending is allocated to prior fiscal years. Funds are provided to fully pay for the cost-of-living-increase component of Proposition 98, and to extend the class size reduction and reading initiatives. See "STATE FINANCES - Proposition 98" above.

2. The Budget Act reflects the $1.235 billion pension case judgment payment, and brings funding of the State's pension contribution back to the quarterly basis which existed prior to the deferral actions which were invalidated by the courts. There is no provision for any additional payments relating to this court case. See "LITIGATION" below.

3. Continuing the third year of a four-year "compact" which the Administration has made with higher education units, funding from the General Fund for the University of California and California State University has increased by about 6 percent ($121 million and $107 million, respectively), and there was no increase in student fees.

4. Because of the effect of the pension payment, most other State programs were continued at 1996-97 levels, adjusted for caseload changes.

5. Health and welfare costs are contained, continuing generally the grant levels from prior years, as part of the initial implementation of the new CalWORKs program.

6. Unlike prior years, this Budget Act does not depend on uncertain federal budget actions. About $300 million in federal funds, already included in the federal FY 1997 and 1998 budgets, are included in the Budget Act, to offset incarceration costs for illegal aliens.

7. The Budget Act contains no tax increases, and no tax reductions. The Renters Tax Credit was suspended for another year, saving approximately $500 million.

After enactment of the Budget Act, and prior to the end of the Legislative Session on September 12, 1997, the Legislature passed a bill restoring $203 million of education-related expenditures which the Governor had vetoed in the original Budget Act, based on agreement with the Governor on an education testing program. The Legislature also passed a bill to restore $48 million of welfare cost savings which had been part of earlier legislation vetoed by the Governor. Both of these bills have been sent to the Governor for signature.

Also prior to the end of the Legislative Session, the Legislature passed several bills encompassing a coordinated package of fiscal reforms, mostly to take effect after the 1997-98 Fiscal Year. Included in the package are a variety of phased-in tax cuts, conformity with certain provisions of the federal tax reform law passed earlier in the year, and reform of funding for county trial courts, with the State to assume greater financial responsibility. These bills have been sent to the Governor, who has 30 days from passage to sign or reject the bills. The Department of Finance has not yet prepared any fiscal analysis of these bills.

Summary of State Revenues and Expenditures

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE—GENERAL FUND (Budgetary Basis)[a] FISCAL YEARS 1993-94 THROUGH 1997-98 (Millions)

				Estimated[b]	
	1993-94	1994-95	1995-96	1996-97	1997-98
Fund Balance—Beginning of Period	$(2,240.0)	$ (1,004.8)	$ (393.8)	1,073.9	858.8
Restatements					
Prior Year Revenue, Transfer Accrual Adjustments	159.2	(217.3)	(5.3)	4.5	–
Prior Year Expenditure, Accrual Adjustments	(88.4)	431.2	118.9	(16.2)	–
Adjustment to Prior Year Debt Service	247.9	–	–	–	–
Adjustment to Prior Year Reserve for Article XVI, Section 8 of the State Constitution (Proposition 98)	–	(261.2)[c]	–	(498.5)	–
Fund Balance—Beginning of Period, as Restated	$ (1,921.3)	$ (1,052.2)	$ (280.2)	563.7	858.8
Revenues	$ 39,422.4	$ 42,375.3	$46,082.1	$49,139.4	$52,368.1
Other Financing Sources					
Transfers from Other Funds	568.7	1,641.3[e]	4,540.8[f]	66.0	162.4
Other Additions	55.8	71.8	61.4	–	–
Total Revenues and Other Sources	$ 40,046.9	$ 44,088.4	$50,684.3	$49,205.4	$52,530.5
Expenditures					
State Operations	$ 10,034.5	$ 10,972.5	$11,687.7	$12,207.0	$13,942.0
Local Assistance	28,846.2[d]	30,958.3	33,132.5	36,619.9	38,813.5[x]
Capital Outlay	–	9.5	28.9	82.7	71.3
Other Uses				0.7	–
Transfer to Other Funds	249.7	1,489.7[e]	4,481.1[f]	– [g]	– [g]
Total Expenditures and Other Uses	$ 39,130.4	$ 43,430.1	$49,330.2	$48,910.3	$52,826.8
Revenues and Other Sources Over or (Under) Expenditures and Other Uses	$ 916.5	$ 658.3	$ 1,354.1	$ 295.1	$ (296.3)
Fund Balance					
Reserved for Encumbrances	$ 316.0	$ 306.3	$ 450.8	450.8	450.8
Reserved for Unencumbered Balances of Continuing Appropriations[h]	51.2	145.7	123.0	–	–
Reserved for Article XVI, Section 8 of the State Constitution[c] (Proposition 98)	261.2	–	–	–	
Reserved for School Loans[i]	–	1,709.7	1,609.7	1,459.7	1,259.7
Unreserved—Undesignated[j]	$ (1,633.2)	$ (2,555.5)	(1,109.6)	(1,051.7)	(1,148.0)[x]
Fund Balance—End of Period	$ (1,004.8)[k]	$ (393.8)[k]	$ 1,073.9	$ 858.8	$ 562.50

Footnotes on following page.

SOURCE: Fiscal Years 1993-94 to 1995-96: State of California, Office of the State Controller.
Fiscal Years 1996-97 and 1997-98: State of California, Department of Finance.

(a) These statements have been prepared on a budgetary basis in accordance with State law and some modifications would be necessary in order to comply with generally accepted accounting principles ("GAAP"). See Exhibit 1 to this Appendix A for the audited general purpose financial statements of the State for the year ended June 30, 1996, prepared in accordance with generally accepted accounting principles. See Note 2 to the Financial Statements for a description of the differences between the budgetary basis and the GAAP basis of accounting.

(b) Estimates are shown net of reimbursements and abatements.

(c) Prior to the 1994-95 fiscal year, the unencumbered and reverted balances of certain appropriations that were restricted for future educational purposes were reserved within the fund balance of the General Fund. Beginning with the 1994-95 fiscal year, a liability will be recognized for the amount that previously had been reflected as the "Reserved for Article XVI, Section 8 of the State Constitution." This change in accounting treatment is being made in order to match expenditures with the K-14 schools' share of General Fund revenues, as computed in accordance with Proposition 98. The effect of the change is to decrease the beginning fund balance of the General Fund by $261 million.

(d) The 1993-94 Budget Act contained a "repayment" in 1993-94 for a "loan" of $190 million of Proposition 98 funds in 1992-93. See "STATE FINANCES - Proposition 98" above.

(e) $1.2 billion was transferred from the General Fund to the Deficit Retirement Fund in two installments on specified dates in the 1994-95 fiscal year. On December 21, 1994, the $1.2 billion was transferred back to the General Fund from the Deficit Retirement Fund to pay and redeem at maturity $1.2 billion of 1994 Revenue Anticipation Warrants, Series A.

(f) $4.2 billion was transferred from the General Fund to the Warrant Payment Fund in four installments on specified dates in the 1995-96 fiscal year. On April 25, 1996, the $4.2 billion was transferred back to the General Fund from the Warrant Payment Fund to pay and redeem at maturity $4.0 billion of 1994 Revenue Anticipation Warrants, Series C and D.

(g) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfer from Other Funds."

(h) Pursuant to Chapter 1238, Statutes of 1990, the unencumbered balances of continuing appropriations which exist when no commitment for an expenditures is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 1997-98 Governor's Budget includes the unencumbered balances of continuing appropriations as a footnote to the statement (including $175.1 million in 1995-96, $176.2 million in 1996-97 and $24.3 million in 1997-98). However, the State Controller's financial statements continue to reflect a specific reserve for the unencumbered balance for continuing appropriations.

(i) During 1995, a reserve was established in the General Fund fund balance for the $1.7 billion of previously recorded school loans which had been authorized by Chapter 703, Statutes of 1992 and Chapter 66, Statutes of 1993. These loans are deferred and are to be repaid from future General Fund appropriations. See "STATE FINANCES - Proposition 98" above for a discussion of the settlement of the CTA v. Gould lawsuit. This accounting treatment is consistent with the State's audited financial statements prepared in accordance with GAAP.

(j) Includes Special Fund for Economic Uncertainties (SFEU). The Department of Finance estimates an SFEU balance of $408 million on July 30, 1997 and $112 million on June 30, 1998.

(k) The 1993-94 Budget Act contained a plan to retire the projected $2.8 billion accumulated deficit over an 18-month period, to December, 1994, in part by using external borrowing in the form of revenue anticipation warrants. See "STATE INDEBTEDNESS — Cash Flow Borrowing" above. The 1994-95 Budget Act reflected a further deferral of $1.025 billion of accumulated deficit to the 1995-96 Fiscal Year. These plans are not reflected in this table.

(x) Assumes enactment of legislation to restore $48 million of program savings initially vetoed by the Governor and also assumes enactment of legislation to restore $203 million of expenditures associated with education upon agreement by the Legislature and the Governor on a satisfactory testing program. These bills were passed and await the Governor's signature.

Revenue and Expenditure Assumptions

The table below presents the Department of Finance's budget basis (accrual) statements of major General Fund revenue sources and expenditures for the 1995-96 and 1996-97 Fiscal Years and estimated for the 1997-98 Fiscal Year.

Revenues
(Millions)

Source	Fiscal Year 1995-96†	Fiscal Year 1996-97††	Estimated Fiscal Year 1997-98††
Personal Income Tax	$20,875	$23,400	$25,522
Sales and Use Tax	15,753	16,430	17,330
Bank and Corporation Tax	5,862	5,770	6,028
Insurance Tax	1,131	1,190	1,219
All Other	2,675	2,415	2,432
Total Revenues and Transfers	$46,296	$49,205	$52,531

Expenditures
(Millions)

Function	Fiscal Year 1995-96†	Fiscal Year 1996-97††	Fiscal Year 1997-98††
K-12 Education	$17,791	$19,988	$21,963
Health and Welfare	14,264	14,761	14,857(x)
Higher Education	5,531	6,180	6,610
Youth and Adult Correctional	3,946	3,834	4,032
Legislative, Judicial and Executive	1,435	1,576	1,637(a)
Tax Relief	457	469	461
Resources	812	819	714
State and Consumer Services	345	370	390
Business, Transportation and Housing	273	300	270
All Other	539	613	1,893(b)
Total Expenditures	$45,393	$48,910	$52,827

(a) Includes expenditure of fine and penalty revenue for support of Trial Courts.
(b) Includes $1.2 billion for payment to Public Employees Retirement Fund in response to legal judgment.
(x) Assumes enactment of legislation to restore $48 million of program savings initially vetoed by the Governor and also assumes enactment of legislation to restore $203 million of expenditures associated with education upon agreement by the Legislature and the Governor on a satisfactory testing program. These bills were passed and await the Governor's signature.
† 1996-97 Budget Act.
†† 1997-98 Budget Act.

SOURCE: State of California, Department of Finance.

The Revenue and Expenditure assumptions set forth above have been based upon certain estimates of the performance of the California and national economies in calendar years 1997 and 1998. As set forth in the May Revision to the 1997-98 Governor's Budget, released on May 14, 1997, the Department of Finance projects that the California economy will continue to show strong growth through 1998, buoyed by the unexpected strength of the national economy in late 1996 and early 1997. The Department has raised its expectations of job growth and reduced its expectations for the unemployment rate in California in the near future, as compared to January, 1997 figures. The Department set out the following estimates which were used in predicting revenues and expenditures for the 1996-97 and 1997-98 Fiscal Year Budgets; also set forth are the Department's most recent previous estimates as set forth in the 1997-98 Governor's Budget, released January 9, 1997.

Economic Assumptions

	1997		1998	
	May Revision	Governor's Budget	May Revision	Governor's Budget
Nonfarm wage and salary employment (000)	13,154	13,100	13,450	13,351
Percent Change	3.0	2.6	2.3	1.9
Personal income ($ billions)	865.2	869.1	917.7	920.5
Percent Change	6.8	6.6	6.1	5.9
Housing Permits (Units 000)	110	110	122	121
Consumer Price Index Percent Change	2.3	2.7	2.3	2.7

SOURCE: State of California, Department of Finance, January 9, 1997 (for "Governor's Budget") and May 14, 1997 (for "May Revision").

LITIGATION

In addition to litigation discussed in Note 20 to the Audited Financial Statements (see Exhibit 1 to this Appendix A at Page 53), the following information is provided concerning those matters and other matters which either have arisen since the date of the Audited Financial Statements or are not discussed in Note 20.

In the case of *Board of Administration, California Public Employees' Retirement System, et al.* v. *Pete Wilson, Governor, et al.*, plaintiffs challenged the constitutionality of legislation which deferred payment of the State's employer contribution to the Public Employees'

Retirement System beginning in Fiscal Year 1992-93. On January 11, 1995, the Sacramento County Superior Court entered a judgment finding that the legislation unconstitutionally impaired the vested contract rights of PERS members. The judgment provides for issuance of a writ of mandate directing State defendants to disregard the provisions of the legislation, to implement the statute governing employer contributions that existed before the changes in the legislation found to be unconstitutional, and to transfer to PERS the contributions that were unpaid to date. On February 19, 1997, the State Court of Appeal affirmed the decision of the Superior Court, and the Supreme Court subsequently refused to hear the case, making the Court of Appeals' ruling final. On July 30, 1997, the Controller transferred $1.235 billion from the General Fund to PERS in repayment of the principal amount determined to have been improperly deferred. Subsequent State payments to PERS will be made on a quarterly basis. No prejudgment interest has been paid in accordance with the trial court ruling that there was insufficient evidence that money for that purpose had been appropriated and was available. No post-judgment interest was ordered.

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